Before the
Federal Communication Commission
Washington, D.C. 20554

In the Matter of	)	
Federal-State Joint Board	)	
On Universal Service	)	**CC Docket No. 96-45**
	)	
Petition of Western Wireless to	)	**RM 10822**
Eliminate Rate-of-Return	)	
Regulation of Incumbent Local	)	
Exchange Carriers	)	

Reply Comments Opposing The Petition For Rulemaking To Eliminate Rate-of-Return Regulation Filed By Western Wireless ("Western")

By:

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I. Background For Reply Comments in Opposition to Western Wireless' Petition for Rulemaking

FW&A is a consulting firm located in Tulsa, Oklahoma that works for small rural Incumbent Local Exchange Carriers (ILECs) that operate in Kansas and Oklahoma. These ILECs serve rural areas that have, on the average, three to five customers per square mile and they have placed or are in the process of placing facilities that will enable nearly 100% of their customers (even those in the most remote areas) to have access to broadband and other advanced services.

On October 30, 2003, Western Wireless ("Western") filed a petition with the Commission requesting that the Commission open a rulemaking to eliminate Rate-of-Return regulation for ILECs and replace such regulation with a forward looking cost model. On January 16, 2004, comments supporting or opposing the petition were filed. FW&A opposes the petition of Western Wireless and requests that the Commission not open a rulemaking to evaluate Western's petition.

II. Commenters In Favor Of Western's Petition Offer Only False Allegations In Support Of Their Position With No Factual Basis

None of the comments filed pervade any factual or substantive evidence or rationale to support Western's petition. Like the petition itself, all that is offered in the comments supporting the petition is rhetoric.

For instance, in an effort to convince the Commission that access rates and the universal service funds are over stated due to actions of rural ILECs, the commenters supporting Western's petition offer blatantly incorrect and unproven assertions:

- "An ROR ILEC can today file tariffs based on wholly inaccurate cost studies that vastly inflate rates…"[1] and "…ROR regulation has permitted massive over-earnings…"[2]
- "…ROR regulation…insulates rural ILECs from the effects of competition and encourages continues inefficiency."[3] and "…ROR regulation helps insulate ILECs from competition and results in 'fraud, waste and abuse"…"[4] The rhetoric continues with: "…the current system [ROR] encourages the rural ILEC to manipulate its study areas to remain small to maximize high-cost support."[5] and "...invites rural ILECs to neglect their customers, because the ILECs are insulated from the full competitive pressures of the marketplace."[6]
- "…expense padding and gold-plating is a systemic problem under ROR regulation."[7] and "…ROR regulation provides ILECs with both the opportunity and the incentive to misrepresent their costs…"[8] The embedded cost standard "…provides an incentive for misallocation of

[1] Comments of General Communications, Inc. (GCI) dated January 16, 2004, page 7.
[2] Id., page 2.
[3] Id., page 6.
[4] Id., page 2.
[5] Id., page 8, information in brackets added for clarity.
[6] Id., page 9.
[7] Id., page 7.
[8] Id., page 12.

costs…"[9] and "It would not be unreasonable to suspect that RLEC books of account also materially overstate relevant costs."[10] "RLECs have little incentive to incur costs efficiently and report them accurately."[11]

- "…some of the growth in the high-cost component of the USF may be attributable to RLEC investments that are not needed to support the services that the USF is supposed to support…"[12]

As usual, these commenters have no facts to back up these false assertions.[13] There is absolutely no evidence that any of these alleged problems are widespread among rural ILECs or that they exist at all. However, in comments to the FCC, where assertions don't have to be proven in hearings, commenters can say whatever they wish, even when untrue.

The facts about ROR regulation are that rural facility-based ILECs are the only carriers that now provide affordable and quality basic universal services with modern and efficient facilities to all consumers in rural areas. The rate and support mechanisms based on ROR regulation have allowed the rural ILECs to accomplish this universal service objective. As a result of these mechanisms, rural ILECs have been able to provide high-quality, fiber-based universal service to all consumers in rural areas where it is costly to provide these facilities.

[9] Ad Hoc Telecommunications Users Committee (Ad Hoc) comments, page 1.
[10] Id., page 6.
[11] Id., page 7.
[12] Id., page 8.
[13] GCI at page 10 and 11 of its comments claims that one ILEC and its subsidiaries, for one access category, over earned for a period of time. GCI offers nothing for this ILEC to show what its overall rate of return was for this period and does not discuss any subsequent refunds of the over earnings that may have been made. On page 11, GCI discusses additional "over earnings" in the NECA pool, but again does not discuss the potential of subsequent refunds of the over earnings. This GCI commentary provides no insight into the overall earnings levels of the ILECs discussed and clearly does not provide any valid basis to claim that all rural ILECs are earning excessive returns.

Where efficiencies are possible, rural ILECs employ them. Rural ILECs are providing these facilities so that all rural consumers they serve will have the capability to receive basic universal services at affordable rate levels. The rural ILECs have nothing to apologize for with regard to the networks they have built – they are modern, efficient, state of the art and provide consumers in rural areas with access to excellent basic services.

There is simply no evidence to support the time-worn assertions that LECs
(a) Misrepresent their costs, (b) Pad expenses and utilize materially overstated, inaccurate cost studies to inflate rates, (c) Gold-plate and are inefficient, and
(d) Engage in a pattern of "waste, fraud and abuse". At odds with the false assertions of Western's supporters, Rural ILECs:

- Have placed and are placing state of the art facilities in an efficient manner to provide high quality services to all customers in rural areas and book those costs in accordance with the FCC's accounting rules (Part 32).
- Allocate expenses and investments between regulated and non-regulated operations as required by affiliate and non-regulated rules (FCC Part 64).
- Allocate the regulated costs between Interstate and Intrastate jurisdictions and to access elements in accordance with FCC rules (Parts 36 and 69).
- Are routinely audited and reviewed by the National Exchange Carrier Association (NECA) and are under the direct oversight of state commissions with whom the rural ILECs file annual cost reports. The state commissions from time to time initiate detailed cost reviews of the rural ILECs as has been the case in Kansas and other states.

Finally, at odds with the claims of commenters supporting Western's petition, Rural ILECs:

- Have no incentive to increase access rates and many rural ILECs are attempting to reduce these charges to assist in the provision of affordable toll and expanded calling services in rural areas. ROR based implicit support (recovery of loop related costs) has been removed by the Commission from access charges. The resulting rate levels are not "unreasonably" high as asserted by Western, but recover costs of rural ILEC facilities used by IXCs and CMRS carriers to originate and complete their interexchange and InterMTA calls, respectively
- Have no incentive to increase high cost support beyond the level necessary to recover their high loop and local switching costs. These facility costs, which now are largely fiber based for loop and are transitioning to the most efficient switching technology, are the major components of high cost support. These facilities are the essential component not only for all carriers, but include Western and its supporters to interconnect with consumers in rural areas. Needlessly increasing these costs puts pressure on the sustainability of these funds, at odds with the incentives of rural ILECs.

The comments of those supporting Western's petition, like the petition itself are comprised of false assertions and mischaracterizations of the facts. As such they should not be given any credence by the Commission.

If there are areas raised in the petition that the Commission wishes to investigate, existing proceedings should be used. For instance, the cost basis of and the size of the federal high cost funds raised in the comments of Add Hoc, GCI, and T-Mobile, and the issue of support auctions and customer vouchers raised by T-Mobile are currently at issue in CC Docket 96-45. They need not be addressed again in a separate proceeding.

III. Elimination Of Embedded Cost ROR Based Rates And Support Mechanisms Would Harm Rural Consumers

Rural ILECs have built and upgraded rural networks to provide efficient and state of the art, high quality basic local service to all customers in their areas.[14] These networks are also used by CMRS, Interexchange carriers, ISPs and ESPs to originate and/or terminate their customers' usage. These networks, which are critical (a) To the provision of reliable and quality telecommunications for consumers living in rural areas, (b) To the delivery of telecommunications in rural areas for all CMRS, IXC, ISP and ESP service providers, and (c) To the economic development, health and safety in rural areas, rely on revenues from embedded cost ROR mechanisms (access rates, support funds) to maintain and upgrade the networks. Elimination of the rate of return based funding sources would, at odds with the assertions of Western's supporters, eliminate the ability

[14] This has been accomplished with the assistance and help lenders such as Co Bank, RUS and the RTFC. These lenders would not provide funding to the rural ILECs for speculative and inefficient ventures. These loans were also approved based on ROR embedded cost based revenue streams from access and the federal support funds. Changes to these revenue streams based on Forward Looking Costs could result in inability to pay these loans.

of rural ILECs to build efficient networks and would harm rural consumers. For instance:

- If support were based on a hypothetical ROR model of costs and if the model and its inputs were designed to reduce support for rural ILEC areas, rural consumers throughout the nation would be the losers. This would cause the Commission to create a service and digital divide between rural and urban areas by providing insufficient support. The Commission should reject the Petition and continue the current support mechanism which provides sufficient support to allow rural carriers to provide affordable and quality basic and advanced facilities and services that are comparable to those found in urban areas, as required by the Act.
- At odds with the comments of T-Mobile that the "…use of a forward-looking economic cost methodology for non-rural carriers has been a success…",[15] where forward-looking costs have been used and where ROR regulation has been eliminated, the incentive of the non-rural carriers is to reduce costs to increase earnings, often with disregard for facility investments needed to maintain high service quality and to provide advanced services in rural areas. In the process, rural areas served by price cap carriers have not been the recipient of innovation and have in fact been left behind in the provision of digital services. There has certainly not been a rush to deploy new technologies that benefit consumers. Even CMRS carriers are not expending the funds to deploy even basic service to all rural areas.

[15] Comments of T-Mobile, dated January 16, 2004, page 5.

The reality of the elimination of ROR regulation and its replacement with price cap regulation and TELRIC-based rates and support for large wireline carriers such as the RBOCs is that:

a. They have laid off thousands of employees in order to reduce costs and increase earnings.
b. They have further reduced other costs (employee benefits, lighting, building and facility maintenance, etc) in order to increase earnings.
c. Capital expenditures have been severely curtailed to the point where it is exceedingly difficult to have necessary trunk facilities added when the existing trunks exhaust.
d. There are few, if any, capital expenditures to upgrade rural facilities or to provide facilities necessary to deliver advanced services in rural areas served by the price cap carrier.

Ad Hoc is wrong when it observes that calculating high-cost support based on embedded costs is contrary to sound economic policy.[16] Similarly, GCI and T-Mobile are wrong when they observe that calculating support (and unbundled network elements) based on forward-looking costs will rationalize the Commission's policies for both rural and non-rural carriers.[17] Time has shown that the use of forward-looking costs (which are manipulated to understate costs) and the elimination of ROR regulation have caused the non-rural carriers to curtail necessary investments and expenses, particularly in rural areas.

[16] Comments of Ad Hoc, page 9.
[17] Comments of GCI, page 13 and 14; Comments of T-Mobile, page 12.

If this “sound economic policy” were extended to rural ILECs, the expected results would be much the same. This is not sound economic theory, but should be recognized as an economic theory that does not work and that produces results that are at odds with the intent of the Act and, if extended to rural ILEC service areas, would harm rural consumers..

IV. Other Assertions Made By Western’s Supporters Have No Basis In Fact

The commenters supporting Western’s petition claim that the current universal service policies for rural ILEC service areas are anti-competitive and erect a barrier to the development of competition[18], are not competitively and technologically neutral[19] and that the use of Western’s proposal would provide a smooth transition plan to competitive markets for rural ILECs.[20] Finally, the commenters attempt to point the finger at the rural ILECs for the growth in the federal support funds[21] and argue that these funds should be needs-based.[22]

At odds with the commenters’ assertions, the current universal service support program based on ROR embedded costs for rural ILECs does not erect a barrier to competitive entry nor is it anti-competitive. There is significant competition in rural ILEC areas from CMRS carriers. In addition there is competition from satellite service providers and increasing competition from cable providers. Wireline ROR regulation has not been a barrier to any of these intermodal competitors.

[18] Comments of GCI, page 15.
[19] Id., page 16.
[20] Id., page 2 and 6.
[21] Ad Hoc comments, page 1 to 5; T-Mobile comments, page 13 and 14.
[22] Ad Hoc comments, page 11; NEXTEL, page 5, T-Mobile comments, page 5 and 11

In fact, GCI's own comments in this proceeding belie the assertion that ROR embedded cost support is a barrier to competitive entry. On pages 3 to 5 of its comments, GCI discusses how successful it has been as a competitor, even with a rural ILEC as a competitor that receives universal service support.

As discussed previously, use of a forward looking methodology and elimination of ROR regulation and the use of a forward looking methodology for developing access rates and universal service support would not, as the commenters allege, provide a smooth transition to the competitive market for either the rural ILECs or the customers in rural areas. First, the rural ILECs already face a competitive market. That transition has already taken place under the current form of regulation. Second, the result of application of the policies advocated by the commenters would, as discussed previously, have the same economically undesirable results as they have had when applied to the large ILECs – loss of jobs, lack of capital investment in rural areas, loss of high-quality service, inability to provide advanced services, etc.

T-Mobile asserts that large carriers are incented to sell rural exchanges to rural ILECs because of embedded cost universal service support.[23] However, T-Mobile neglects to mention the fact that the Commission has rules that mitigate this incentive. Under the Commission's rules, a purchasing carrier, such as a rural ILEC, may not receive any more support per line that the selling carrier receives. Large LECs are, in fact, incented to sell exchanges because they no longer are able to invest in rural areas because of the elimination of ROR

[23] T-Mobile comments, page 12.

regulation and the imposition of non-compensatory TELRIC (forward-looking cost based) rates.

Finally, the ILEC growth in the federal funds is not, as the commenters allege, as a result of manipulation, etc., of costs, but is in large part due to the Commission adopted changes resulting from the MAG and CALLS plans.[24] The commenters are correct, however, that the funds should be needs-based. The rural ILECs have proven their cost-based need, unlike other wireline and wireless ETCs. As shown on the Attachment to these comments, wireless ETCs or potential wireless ETCs may not need this support, based on an analysis of their average costs. If this is the case, the support funding they would receive will be a windfall to their stockholders.

V. Customer Vouchers and Auctions Are Not in the Public Interest

T-Mobile claims in its comments (pages 16 to 18) that support should be provided based on either customer vouchers or competitive bidding among providers (auctions). T-Mobile wrongly asserts that these mechanisms would provide universal service support at the lowest price, there could be sizable reductions in the size of the universal service fund and that their use would eliminate the waste and inefficiencies associated with the current program.

[24] Aside from the MAG and Calls plan revisions to the fund, it appears that it is competitive ETC's that are raising concerns about growth in the universal service fund. In a recent Memorandum Opinion and Order involving Virginia Cellular, released January 22, 2004, at paragraph 31, the Commission stated that "…we are increasingly concerned about the impact on the universal service fund due to the rapid growth in high-cost support distributed to competitive ETC's."

Although this is the wrong proceeding to argue these issues, the proposals made by T-Mobile will not work and will not insure that there is sufficient support to insure that there are quality universal services at just, reasonable and affordable rates for all customers in rural ILEC areas. Providing service requires a high quality network that serves all customers. Currently, the rural ILECs serve this carrier of last resort (COLR) role. Sufficient support must be provided to offset these high network costs to insure that the Act's universal service goals will be accomplished.

Providing universal service support to customers instead of the network providers will not provide the revenues that are required to build and maintain the network. Likewise, auctions will not provide sufficient support. CMRS ETCs, who are not required to serve the entire study area and thus have lower costs than the COLR, will have an anti-competitive bidding advantage. As a consequence, support will be bid lower than necessary for any ETC to provide and support a high quality network that can serve all customers with affordable rates.

VI. Summary

The Commission should not risk the advances made in providing quality basic and advanced service to consumers in rural ILEC areas by giving credence to, and considering, in a separate proceeding, the specious assertions in the Western Wireless Petition and the comments of Western's supporters.

Instead of opening a separate proceeding, the Commission should use existing proceedings to evaluate, as necessary, costing for all ETC, universal service funding methodologies, etc.

Respectfully submitted by,

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